ALTERNATIVE APPROACHES TO THE NATURE AND CAUSE OF PRICE INFLATION: 1947-1957

A THESIS

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PREFACE

The objective of this thesis is to supply a brief, simple, but reasonably comprehensive introduction to the subject of price inflation, including therein some description of price movement, its nature and causes.

It is hoped that, by having in the compass of this thesis several approaches to the nature and causes of price inflation, the reader will be able to see the full scope of inflation; its nature and its causes in the selected period.

My debts of gratitude are many. I should like particularly to acknowledge Doctor Samuel Z. Westerfield, whose helpful suggestions and patient assistance have proven invaluable in the preparation of this thesis; and to Mrs. Ruth Ross for most welcome typing assistance and for checking the text for correctness in form. I am also indebted to Mrs. M. M. Yates for her assistance and for materials made available by her office.

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CHAPTER I

INTRODUCTION

The rise of consumer prices during the past year or two has again stirred up a lively interest on the subject of inflation. Some observers argue that we are, or recently have been, experiencing the familiar price-wage spiral as a result of too much money chasing too few goods. Others claim that we are, or recently have been, experiencing a new kind of inflation. Some see the newness in administrative pricing by business, others see it in the upward push of wages on cost, while still others see it in the continued advance of prices despite a "tight-money" policy and federal surplus. Some blame the trade unions for pushing up wages and expanding fringe benefits, others blame business firms for making up prices, still others blame bankers for charging higher interest rates. And many criticize the Federal Government for having allowed all these things to happen, or for spending too much money, or for taxing too heavily or for taxing too lightly.

The questions that have been raised by the recent public debate on inflation are as difficult as they are important. If economists could speak with a clear and authoritative voice of the subject, there would be nothing to do except to dust away confusion. Economic knowledge has not yet reached that state, and perhaps it never will.[1]

At the close of World War II many economists preducted a major depression as soon as the country's pent-up demands for goods was satisfied. Congress was sufficiently concerned to pass the Employment Act of 1946 in an effort

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[1]Arthur F. Burns, Prosperity Without Inflation (New York, 1957), pp. 1-2.

to prevent a return to conditions of mass unemployment. The National Resources Planning Board prepared a series of reports on post war employment and public works policies. The specter of the 30's still hung over the country, and the young war veterans were frankly anxious about their job opportunities as they faced return to civilian life.

But the expected collapse did not occur. The wartime prosperity which started in 1940 continued into the 50's supported by record high peace time arms expenditures. Most Americans found little difficulty in getting and retaining jobs at unprecedentedly high wages. In fact, at many periods there was a shortage of labor. Business soared to undreamed of heights.

In spite of the general prosperity, many individuals and groups suffered a few jolting blows. Farmers were well off during the Korean War, but had a setback after the cease-fire. There was industrial recession in 1957-8 during which unemployment surpassed or came close to the five million mark. And countless American, particularly white collar workers, were badly squeezed by the spiraling cost of living.[2]

Nature and Causes of Price Trend 1947-57

The recent trend of wholesale and consumer prices reflects numerous and complex developments in the markets for many hundreds of commodities and services. But one fact towers above all others, and to a large degree sums them up -- namely, the great and sustained expansion of aggregate demand which has kept the economy operating in a state of practically full employment during almost the entire period since the end of World War II.[3]

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[2] Maxwell S. Steward, "How Can We Stay Prosperous," Public Affairs Pamphlet, No. 270, August, 1958, pp. 1-2.

The initial impulse to explansion was imparted by the willingness and ability of both consumers and business firms to spend money freely on the many commodities which had been in short supply or entirely unavailable during the war. Other forces soon gathered strength, reinforced one another, and gradually deepened the confidence of people in their own economic opportunities and in the economic future of the country. The most important of these factors were the unexpected upsurge of population, the expansion of the middle class, the on-rush of technology, and intensified pace of business competition, the resurgence of Western Europe, and general recognition of government's responsibility to help maintain prosperity. Although federal expenditures played a significant part at times in stimulating markets, the main drive toward economic expansion came from the private economy. It is well to recall how promptly the decline in federal spending after the end of the war was offset by expansion in other parts of the economy. Between the second quarter of 1945 and the second quarter of 1947 the annual rate of federal expenditure on goods and services declined by 74 billion dollars. In the meantime, the rate of expenditure by the rest of the economic community rose to 80 billion. Much the same thing happened after the Korean truce. Despite a decline of 15 billion dollars in the annual rate of federal spending, the rate of total national expenditure increased 20 billion dollars between the second quarter of 1953 and the second quarter of 1955.[4]

The great expansion of demand during the post-war years made its influence felt in nearly every market, but especially in the capital goods industries. Between 1946 and 1956 our total expenditure on goods and

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[4] Ibid., pp. 2-3.

services or the dollar value of the nation's output, nearly doubled. During the same period the outlay on fixed capital -- that is, on business plants, machinery, new homes, automobiles, roads, school buildings, military hardware, and other durables -- increased 168 per cent. Expenditures of this type were 23 per cent of the nation's total output in 1946. A year later they rose to 28 per cent or a full point above the level of 1929, when the boom of the 1920's was culminated. The advance did not stop there. By 1952, spending on fixed capital reached 32 per cent of total output; and this ratio has been maintained with only slight variations, since then.[5]

The heavy concentration of the nation's spending on fixed capital was made possible in large part by credit expansion. Since durable goods and new structure are costly as well as long-lived items, they are often purchased on credit. Thus, while the federal debt changed very little, the outstanding private debt rose from 154 billion dollars at the end of 1956 to the enormous total of 416 billion dollars ten years later. In the meantime, the debt of the states and localities also rose sharply -- from 14 to 43 billion dollars. The close connection between this proliferation of debt and the intense demand for capital goods is evident from the fact that mortgage debt, long-term corporation debt, consumer instalment debt, and state and local debt, taken together, account for nearly three-fourts of the debt expansion that occurred during the decade.[6]

The huge expansion of demand for capital goods, along with the increase of demand for other commodities and services, was financed in part by the creation of new money, but in still greater part by a more active use of the

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[5] <u>Ibid.</u>, pp. 3-4.

[6] <u>Ibid.</u>, p. 4.

existing stock of money. This is evident from the fact that the dollar value of the nation's total output increased 116 per cent between the end of 1945 and the end of 1956, while the money supply -- that is, demand deposits plus currency in public circulation -- increased only 36 per cent.[7]

The vast expansion of the nation's aggregate demand, which was facilitated by an unprecedented expansion of credit, tested the nation's physical capacity to produce during much of the post war period. We see evidence of this in the low level of unemployment that has characterized most of the post-war years, despite the increasing rate of participation of people in the labor force. We see it also in the persistence of substantial amounts of overtime work. The pressure of demand on physical resources became especially strong in the durable goods and construction industries. Of this, too, there is abundant evidence. We see it in the more rapid growth of physical production in the durable goods and construction industries than in the production of non-durables and services. We see it in the high level of unfilled orders on books of manufacturers of durable goods. We see it also in the persistence of a longer work week in durable manufactures than in those producing transient goods.[8]

When demand presses hard on a nation's stock of physical resources, cost of production and prices cannot remain stable. That at least is true as long as markets are reasonably free and competitive. Under such conditions employers bid actively for labor, whether it is organized or not, and wages tend to rise. Prices behave in similar fashion, sometimes rising before and sometimes after

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[7] *Ibid.*, pp. 4-5.

[8] *Ibid.*, p. 6.

wages increases. Every rise of wages and other incomes tend for a time to stimulate consumer demand. Business investment likewise tends to expand, partly because markets are growing and partly because a new plant or a new piece of equipment is often the only effective means of reducing the pressure of rising labor costs. If income or both price and income are expected to move still higher, the impulses of expanding demand are again strengthened all around. There can be little doubt that such expectations have ruled over a great part of the post-war period, or that the ability of trade unions to win wage increases which substantially exceed the increases that have been occuring in general industrial productivity did much to kindle and fan the expectation of rising prices and incomes. Thus, expanding demand served to pull up both prices and wages, while rising wages served to push up both demand and prices. With minor interruptions, this cumulative and interacting process of rising wages, rising prices, and rising economic activity has gone on since the end of the war under the sheltering umbrella of the monetary and fiscal policies of government.[9]

The broad results are entirely familiar. Between 1946 and 1956 the wholesale price level rose 45 per cent and the consumer price level rose 39 per cent. If we omot 1946, when reported prices did not as yet reflect adequately the restoration of free markets, the increases are much smaller but still substantial: 19 per cent for wholesale and 22 per cent for consumer prices. Wages rose even more rapidly. Labor compensation per hour in the private non-agricultural sector of the economy moved up 61 per cent between 1947 and 1959, while non-agricultural prices at wholesale rose 28 per cent.[10]

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[9] *Ibid.*, pp. 6-7.

[10] *Ibid.*, pp. 7-8.

The heavy concentration of demand on capital goods had repercussions that were felt throughout the economy. This demand could hardly have attained the immense proportions of the post-war years without an enormous expansion of credit. Nor did the effect of buying on credit stop with the capital goods industries. The incomes disbursed by these industries were in largest part spent rather promptly by the consuming public on all sorts of goods, the production of which in turn generated new incomes and again stimulated new spending. But if credit expansion was a key factor in price inflation since the war, so also was the influence of trade unions. Their power in the capital goods industries is great. They used it to win substantial increases in wages and related benefits for their members and thereby set the pace for wage negotiations in other industries. In view of the favorable state of demand, producers in the capital goods industries were usually in a position to reduce or escape the pressure of rising labor cost by charging higher prices. They did so with considerable frequency, and sometimes even raising prices beyond what their increased labor costs might justify. The capital goods industries thus became the principal center from which advances in costs and prices spread through the economy.[11]

We are now in a position to examine more closely the price developments of the past two or three years. The stability of consumer prices which ruled between 1952 and the spring of 1956 proved ephemeral. After the mild recession which followed the close of hostilities in Korea, another great buying wave got underway in the late summer of 1954. Production rose sharply, first in a few industries, later on a wide front. Within a year,

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[11] *Ibid.*, pp. 8-9.

the moderate amount of unemployment that had accumulated in preceding months was wiped out. The price level remained stable for a time, notwithstanding the wide rapid advance of economic activity. But aggregate expenditure for capital goods kept increasing even after activity in the home-building and automobile industries receded. Credit expanded at a very fast rate, just as it did at the time of the Korean upsurge. During 1955 and 1956, individuals and corporations added 73 million dollars to their debt -- an increase of 21 per cent in two years. States and localities increased their indebtedness by 9 billion dollars -- a rise of 28 per cent. Although the money supply proper grew by only 5 billion dollars, the combined supply of money and its close substitutes grew by 30 billion dollars. Meanwhile, with the economy working at practically full capacity, the rate of increase in physical output declined materially and the rate of increase in industrial production declined even more. Wages, on the other hand, advanced energetically. In these circumstances neither could not did prices remain stable. By mid-1955 the level of wholesale prices began to move up again. Nine months later consumer prices, of food as well as most other items, visibly joined the rising processions. In the race between demand and supply, demand once more proved the stronger.[12]

Definitions

Price is the quantity of one thing, usually, exchanged or demanded in barter or sale for another.[13]

Many factors are combined to make prices what they are. For prices are

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[12] *Ibid.*, pp. 11-12.

[13] Merrian and Webster, *Webster's Collegiate Dictionary* (Springfield, Mass., 1942), p. 786.

the major criterion by which the producer can feel the pulse of the public. He can know whether to produce cabbage or collars, wheat or rye, lamb or beef, and/or cars or trucks. The system is not perfect, but no other known system can guide the millions of producers to meet the needs of people so well as prices do.

Finally, a small, continuing price rise may act as a business stimulant. Profits, especially in money terms, are boosted, encouraging economic expansion not only by providing stimulus and buoyant optimism but also funds to pay for equipment. Whatever the merits of this argument, they disappear if we cannot assume that inflation will be limited to fairly steady, and certainly small, amounts. The expected benefits would likely disappear if businessmen and investors realized what was happening, as they doubtless would soon.

Prices change. They change as hours, days, weeks, months, and years. Every change affects the relationship of individuals, of groups of people, and of nations.

Price changes are even more important in their effect on the total production and national welfare. When prices are rising, industry is stimulated. Those who borrow to produce, or buy for sale on a larger market, prosper. The government that is in debt finds payment easy because taxes so easy of payment that governments are likely to take on new needed services and contract further debts. Buying in advance of needs is stimulated. A spirit of optimism and good-will prevails.[14]

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[14] G. F. Warren and E. A. Pearson, Prices (New York, 1953), pp. 1-3.

We use the term inflation to mean a presistent rise of prices "in general." The term is sometimes used with other meanings. For example, inflation is sometimes used to mean an increase in the money supply.

Inflation is a general, over-all increase in prices, that is, in the price level. Not every price may rise, and certainly not all by the same proportion; but the average does. The cause (a major necessary condition) is an increase in spending that results from a growth in the stock of money or the speed with which it is used.[15]

Inflation, like a submarine, cannot always be spotted. It is a phenomenon of many degrees, and the term is applied to illnesses ranging from a mild cold to a massive cancer. Some inflations are astronomical -- the German inflation after World War I (prices rose by about 400 billion times). Others are disruptive, revolutionary, overwhelming, yet not great enough to make the currency worthless; in Italy and France after World War II, for example,money depreciated to one fiftieth or theraabouts of its pre-war value. Then there are inflations like ours since 1940 in which prices about doubled.[16]

Inflation is evil. Like the tempting siren, it may lure us with glorious visions, but the rocks below can shatter our ship. The most obvious evil of inflation is its cruelty. People who have put their savings into forms that give them claims on money -- pensions, life insurance, savings accounts, bonds -- find that their money buys less and less. The tragedy is especially pitiful because, for large numbers of people, the money had been saved for a period when they could not provide for themselves -- illness or retirement.

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[15]C. Lowell Harriss, The American Economy (Homewood, Illinois, 1956), p. 724.

[16]Ibid.

only slightly less distressing are the cases of people whose incomes, though perhaps rising, increase less rapidly than price rise. Ministers college teachers, government employees, landlords, persons with fixed-income assets lag behind. There is little liklihood of either justice or economic efficiency in the income changes that result during inflation.

Other evils, though perhaps less dramatic, are economically and socially corroding. Inflation, at least after it has presisted for a while, is economically wasteful. As there are changes in the value of money, the measuring rod which ties together financial relationships, the conduct of business becomes harder; rational calculation gets more difficult. A new source of risk is introduced; alternatives involving the future cannot be weighed as well as if the measure, money, were to remain stable. Choice of occupation becomes more difficult. Some firms will not undertake ventures which would be beneficial to the community; others, benefiting from rising inventory values or the chance to sell at prices which rise more rapidly than costs, over estimate their profit, over state the chances for this profit to continue, and over extend themselves or make errors. The allocation process, efficiency in resources use, suffers. Moreover, an inflationary economy will get out of adjustment with other countries; trade restrictions and barriers that obstruct international exchange will likely follow. Easy money and the assurance of jobs induce some relaxation in the determination to put forth the best day's work possible. Careless, slovenly results are to be expected when the threat of unemployment and employer discipline is weakened. Even what may seem a small decline in average human effort -- say 5 per cent -- will cost the economy heavily.[17]

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[17] Ibid., p. 725.

Inflation probably cuts a community's long-run capacity to produce. It eats away, directly and indirectly, the community's capital. The physical capital built when prices were lower will generally be carried on the owner's records at a figure below its replacement cost. The depreciation costs used in fixing selling prices will not be high enough to permit the owner to replace his capital equipment. Consumers, in effect, use up capital without paying for it adequately. Inflation endangers the capital stock in another way -- by discouraging saving and encouraging families to consume their capital. Some saving will be made, even though the saver cannot expect to get back in capital and interest as much purchasing power as he gives up; some saving is more or less compulsory -- pension plans and mortgage reduction, for example. Yet, if the value of money is deteriorating and seems likely to continue to do so, the holding of fixed claims to money becomes less attractive. Capital formation that is tied in with lending will decline, and saving will be confined more largely to forms of direct purchase of assets by the saver.

Finally, inflation (except when small and gradual) has had social effects. It adds a source of discontent and internal dissension. Group can be pitted against group on the basis of inequality in the sharing of inflation. Self-pity and animosity cut the value of human life. Social cohesion is reduced. Rancor, bitterness, and loss of scruple are likely. The growth of crime has been noted where inflations are large; corruption and efforts to benefit by evading regulations thrive.[18]

Good effects are sometimes attributed to inflation. The extreme is the

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[18] *Ibid.*, p. 725

endorsement of inflation as a way to expropriate the property of the middle and upper wealth groups. Such bloodless revolution can destroy vital segments of a society and shift power and income to a new group; when the Communists took over Hungary after World War II, for example, inflation seems to have been produced deliberately. Less extreme is the argument that some inflation is good because it cuts the burden of debt (such as government debt); less sacrifice is involved in paying a given number of dollars of interest and principal; the owners of the debt, of course, suffer a loss equal to the gain of others.

Another argument is that inflation may produce desirable shifts of resources. Perhaps when an economy is up against a servere strain, such as war, changes in relative prices (within a given price level) and direct allocations of labor and materials cannot bring a big enouch transfer of resources quickly to maximize military output. Some price and wage increases will speed the shift of labor and other productive capacity -- and rise the average level of prices. Reducing wage rates and incomes in industries producing "civilian" goods may be a slow process, but boosting them in military industries may be easy and quick. Moreover, higher prices will force a reduction of consumption, especially by those whose incomes do not rise proportionately. Although taxes could also cut consumption to free resources for military production, the potency of inflation must be recognized.

But we believe that the identification of inflation with generally rising prices is common usage in the United States today. Certainly most of the significant statements we make every day about inflation are statements about a general rise in prices. It is the rise in price that reduces the purchasing power of the dollar, that squeezes the living standards of pensioners, that makes depreciation allowances inadequate to cover replacement cost, and so on.[19]

Nor do we regard a moderate fluctuation of prices, such as price rise that normally occur when business is expanding, as evidence of long-term inflation, so long as the economy is sufficiently elastic to allow any general upward fluctuation to be balanced by subsequent downward fluctuation of prices. We are concerned about the possibility that prices will show a strong upward trend. This may occur if prices increase more during expansion than they decline during contraction, or if prices move up sometimes but never down.[20]

Purpose

It is the purpose of this study to examine the different approaches to the cause of price inflation in the interim 1947-1957; to show the nature of each inflationary gap; and to determine if the cause of price inflation can be directly associated with labor, business management, or governmental fiscal policy.

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[19] Ibid., p. 726.

[20] "Defense Against Inflation," Committee for Economic Development, 1958, p. 17.

CHAPTER II

TRADITIONAL CONCEPTS

Most of the economic writers of the eighteenth and nineteenth centuries held that the general level of commodity prices is somehow directly related to the supply of the precious metals which serve as money. But there developed wide differences of view as to the process by which changes in the money supply brought about corresponding changes in commodity prices. Since these diverse conceptions are also found in present-day discussions, it is essential that we examine the several monetary theories that have been developed.

Those who emphasize the value of gold as the determining factor in price levels start with the fact that under the gold standard a certain weight of bullion is legally defined as the standard, or measure, of values in general. It seemed obvious that any factor which affects the value of the commodity adopted as a standard would automatically affect the prices of commodities expressed therein. In the words of British economist Ricardo: "If the value of money were to fall, the price of every commodity would rise, for each of the competitors would be willing to spend more money than before on its purchase."[1]

The theory that price movements are simply reflections of changes in the value of the commodity, gold, was rooted in observations of primitive barter exchange -- in which commodities, including specie, are traded directly one for another. In early gold mining communities, for example, gold dust

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[1]Harold G. Moulton, Can Inflation Be Controlled (Washington, D. C., 1958), p. 10.

or nuggets were in fact commonly traded directly for supplies, provisions, and other goods and services. Where miners struck it rich and came to town on a Saturday evening with an abundance of the yellow metal, they would be willing to exchange it on a liberal basis for goods and services desired. The exchange involved a direct comparison by individuals possessing gold and goods respectively -- with each party weighing comparative utilities.[2]

Meanwhile a second approach to the price problem had been developing. In this line of reasoning a unit of gold is not compared with a unit of wheat, cloth, or other commodity. Rather, the total number of monetary units, or counters, in circulation is compared with the total number of units of commodities being offered in exchange. Instead of thinking in terms of money as a standard, or measure, of values, the thought of these writers run in terms of another function of money -- that is, as a medium of exchange.

In its simplest form the comparison would be only between the quantity of specie in circulation and the volume of goods offered in the market places. But as other, supplementary, forms of currency came into use it was seen that the exchange process involved all forms of money, including checks. Moreover, it was reasoned that since the money supply was normally used many times over in the course of a year, the velocity of its circulation also had to be taken into account. Eventually all this was formalized in a so-called equation of exchange, which held that the number of monetary units in circulation divided by the number of units of goods equal the price level. In this approach it is assumed that the money supply and the goods supply are in no way connected -- that they are independent variables. The money supply is held to be governed primarily by the output of gold

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[2]*Ibid.*, pp. 10-11.

mines while the goods supply depends upon the physical factors governing production -- land, labor, capital and management. Implicit in this analysis is the assumption that money is in no way related to production -- that it enters the picture only in connection with the exchange process.

While the price level might be affected by quantity changes on the money side or goods side of the equation, it was held that changes in the production of precious metals were the primary cause of changes in the level of prices. Thus the price revolution of the sixteenth century was explained by the discoveries of gold and silver in the New World; the decrease in the price level between the Napoleonic Wars and the Middle of the nineteenth century by the declining annual production of gold; the ensuing rise of the 1850's by the discovery of gold in California and Australia; the decline in the seventies and eighties by the gradual depletion of gold mines; and the rise beginning in the nineties by a combination of new gold discoveries, in Alaska and elsewhere, and the development of the cyanide process which made possible the profitable extraction of lower grade ore.

It was early recognized that the forces affecting the prices of commodities transcend the bounds of individual countries. Since gold was produced in many parts of the world and was readily transported from country to country, the value of gold, like that of wheat and cotton, was said to be determined by world-wide conditions of supply and demand. It was reasoned that a fall in the value of gold in consequence of the discovery of rich new mines or a more efficient exploitation of old ones would shortly be reflected in rising prices throughout the world.

The international monetary system reached its culmination in the period just preceding World War I. Most of the world was on the gold standard: exports and imports, together with the service items which help to make up the total of international economic operations, were virtually in balance; exchange rates moved in a narrow range between the gold export and import points and specie flowed in modest amounts in response to temporary needs. Economically speaking, the world could be said to have reached a state of balanced equilibrium.[3]

More or less contemporaneously there was evolving what has come to be known as the income approach. The focal point of attention with this approach is the flow of money-income to individuals. In a pecuniary society the great bulk of individual income is received by participants in the productive process in the form of wages, interest, rents, and profits. Since this stream of money income is more or less concurrently disbursed in payment for goods and services desired, it promptly moves again through the channels of trade and production until it is once more disbursed in the form of money income. This circular flow is of course continuous -- though, to be sure, it may fluctuate in magnitude with changing business conditions with this approach is demand -- since the effective market demand for commodities depends upon the aggregate money income in the possession of consumers.

The income approach differs from the value of gold and quantity of money theories in one vitally important respect. The analysis is not anchored in a gold base nor in the existing stock of money. Under the value of gold and quantity of money theories, as we have seen, the price level is supposed to be governed, directly and automatically by changes in the over-all supply of gold, or money. No thought is given to the possibility that some of the potential money supply might be idle or that the proportion

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[3] Ibid., pp. 11-14.

used might fluctuate widely from time to time. The income approach holds that only the actual stream of money income currently being received and expended affects market prices. Fluctuations in such income are governed by the factors responsible for changes in general business conditions, and in the rates or remuneration to those who engage in production. Moreover, longer term price changes may vary widely from the supply of gold and other forms of money.

While the income approach was first outlined as early as the middle of the eighteenth century, it was not until recent times that it gained extensive vogue. As we see, it now occupies a prominent position in current explanations of general price movement.[4]

The State of Contemporary Thinking

Perhaps the most common explanation of the advance over this period as a whole runs in terms simply of the increased supply of money in circulation. An increase in the supply of money lowers the value of the monetary unit. This is another way of saying that it raises both prices and cost.[5]

Numerous writers have defined government borrowing from banks as "monetizing" the public debt. The government borrows from the banks by selling its securities to them and the banks write up deposit credits for the government to use. This process inflates the banking system, on both the assets and the deposit side of their books. It blows up the system far beyond its normal.... Inflation of the banking system inflates the money supply. The influence of the vast increase in the money supply premeates

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[4] _Ibid._, pp. 14-15.

[5] _Ibid._, pp. 16-17.

the whole economic structure and affects all our economic life.... The increase in bank deposits resulting from government borrowing at the banks has been held responsible for an artificially low level of interest rates, which further stimulated advances in prices.

So long as the public debt continues to be monetized through the purchase of government securities by the banking system, the supply of money will continue to increase, thus tending further to reduce the interest rates on savings and investment funds. The resultant pressure of an increasing money supply and of lower interest rates is bound to have a further inflationary effect upon all capital assets and to increase the difficulty of holding down the cost of living.[6]

Another group of economists emphasizes the increase in mass incomes, and intense demand for consumer goods as the primary cause of the great advance in prices. To be sure, both supply and demand are taken into account but "excessive demand, not deficient supply, is the core of the difficulty."

"Inflation" has its genesis in an increased volume of spending by consumers, business and government. The increase in spending can ordinarily be matched only in part by an expansion in the volume of commodities and services offered for sale.... With more money and no more civilian goods to spend it on the income recievers of the country would, of course, be apt to bid up prices.

The total purchasing power of consumers was greatly swelled, during and after the war, by record employment at generally higher wage rates and

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[6] *Ibid.*, pp. 20-21.

rise in net farm income, backed by accumulations of liquid assets roughly equal to a year's disposable income, and supplemented by credit resources for acquiring durable consumer goods and homes. War and postwar policies toward veterans, farmers, and wage earners have notably added to the volume of purchasing power in money terms.[7]

A few writers place primary emphasis upon forces operating from the cost side. There is a strange contradiction between the insistence of Federal officials and the need for price stability and their failure to deal in a realistic way with the underlying inflationary forces which they and their predecessors have done so much to create. Step by step through many years, a structure of inflation has been built into our economy. Higher wages and higher farm prices have been consistent aims of Federal policy. It would be difficult to find two points in the price structure where political pressure could be applied with great effect on the general price level and the cost of living. As prices in general have moved higher, federal pressure in these two fields has been stronger and more direct. There is a similar inflationary interaction between wages and farm prices, especially since the wide-spread adoption of the escalator clause in union contracts. Higher farm prices mean higher cost of living. Higher cost of living mean higher money wages, which mean higher prices for the industrial products bought by farmers. Higher prices for the things the farmer buys mean higher farm-price parities and higher support prices for farm products, and so on.[8]

The immediate post-war rise in the prices of products, other than food

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[7] Ibid., pp. 21-22.

[8] Ibid., p. 23.

stuffs, was determined mainly from the cost side and not from the demand side. Prices were related to the respective changes in wage and productivity and also to pricing policies of business organizations.[9]

[9] *Ibid.*, p. 23

CHAPTER III

Labor Unionism

Some industrial and financial leaders in the current depression are also engaged in the act of deflecting attention from our serious unemployment problem to the issue of inflation. The ink was hardly dry on the proposals by the Committee for Economic Development to stimulate our economy through tax reduction, when this group issued a sophisticated exposition of its views on inflation.

Inflation suddenly loomed up as a major issue, peculiarly, at a time when overall price stability was most apparent. Moreover, the committee, seeking a scapegoat for its fears, found it in the trade unions. Latching on to the new theory of inflation described as the "wage-price" explanation, it declared that the "main problem is in the field of labor where there is no law or not even a public philosophy or policy for the limitation of economic power."[1]

Other economists who wanted to prove their impartiality and moderate the seeming animus against business resulting from changes of abuse of economic power in price administration glibly coupled the business corporation and labor as the cause for price increase. By a sleight of speech, they have implied that labor means organized labor and, therefore, the trade-union movement. The cause of price rises lies, they reasoned, with abuse of power by both corporation and trade unions. Among some businessmen and economists, it has become popular to speak of the inflation experience

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[1]"The Joint Economic Committee Congress of the United States," The Relationship of Prices to Economic Stability and Growth (Washington, 1958), pp. 4-5.

from 1955 to 1957 as having been produced by pressures from the cost and not the demand side. They found it easy to explain the inflationary cycles created after the second World War and the Korean incident, but the recent experience was new and baffling. Superficially, they witnessed price rises. Wage rates also tended to be increased by reason of the progressive upward movement of the Consumer Price Index. It is easy to characterize the results as a "cost-push" inflation overlooking the role of the oligopolist. There was not much difficulty for these then to switch the characterization to "wage-cost" inflation. The whipping boy thus became the trade unions which had forced sellers to increase their prices. This new phase took big business off the hook.[2]

The number of assumptions have been made in the presentation of the influence of wage increases on our economy which need further clarification. The charge direct or implied, that trade unions are responsible for the price movement should be challenged. First, union contracts are not as pervasive as is implied. Significant employers remained unorganized even in the most highly unionized manufacturing industries. The policies followed by many companies are unilaterally determined.

Second, the blue-collar or production-worker segment of our economy is being materially reduced so that wage increases negotiated by it have a decreasing impact upon final cost. Recent evidence on the changes in employment in the manufacturing industries indicates that the ratio of production workers to all employees has decline from 83.7 per cent in 1947 to 76.9 per cent in 1957. While the total number of production workers

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[2] *Ibid.*, pp. 18-19.

had increased over the 10-year period by 1 per cent, the non-production workers had expanded by 55 per cent. The greatest rise had taken place among professional and sales personnel. What is most significant is that the ratio of non-production workers has been particularly high in some of the expanding and oligopolistic industries.

Third, the rate of wage increase among the non-production workers appears to have been even greater than among blue-collar workers.

Fourth, many unions have negotiated varying amounts of wage increases much below the patterns set by the pace makers, because the bargaining and economic situations in their area were not favorable or their economic power was insufficient to yield more equitable results.

Finally, the discussion of the influence of unions on wages frequently proceeds from the assumption that the union administers wage policies and that they stem exclusively from the rooms of executive and negotiating committee and mass meetings of the union. Wages are negotiated between two contending parties, each seeking to promote the interests of its own constituency.

The responsibility for negotiations and wage policy from the point of view of the enterprise, and even the full economy, rests with management. If there is public dissatisfaction with the wage package it agrees to, bases on criticism of management assumptions concerning its capacity and the propriety of passing on higher costs and higher margins to the public in the form of higher prices, the remedy rests in limiting this power to increase prices rather than in interferring with the collective bargaining process itself.[3]

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[3] Ibid., pp. 22-24.

Actually, labor has been a victim of inflation and not the cause of it. Throughout the entire period of prices in the post war decade, labor's gains were less than it had a right to expect.

Labor unions long ago made the principle of fair share in increased fruits of the economy a basic part of their philosophy. Experience has shown that unless the fruits of rising productivity are shared equitably we soon have over-production and depression. New machines and methods enable us to turn out more goods and services, but if our ability to consume and buy up goods and services is not increased correspondingly, idle men and idle machines are inevitable.[4]

What gains has labor actually made during the period if inflation which has troubled the country since the end of World War II? A recent report issued by the Joint Economic Committee of United States Congress sheds light on this. It shows that between 1947 and 1956 the real wages (that is, wages adjusted to reflect changes in the purchasing power of a dollar) of all workers in the United States went up 32.8 percent. In other words, on the average, wage and salary workers were able to buy 32.8 percent more in 1957 than in 1947 with each hour of pay received. If one includes the cost of fringe benefits along with wages increases, the gain in average hourly compensation for wage and salary workers was 35.2 percent during this period.[5]

Using a formula which states the actual gain in output per man-hour conservatively, the Joint Economic Committee found that the rise in productivity for the entire private economy during this period was 37 percent

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[4]Labor, Big Business and Inflation (Industrial Union Department, AFL-CIO), Washington, September, 1958, pp. 5-6.

[5]Ibid., p. 6.

which shows that total real compensation for employees, including wages and fringe benefits, had not kept pace with rising output of the economy as a whole.

TABLE 1

INCREASE IN LABOR PAYMENTS COMPARED TO
INCREASE IN OUTPUT PER MAN-HOUR
1947-1957

	Per Cent 1947	Per Cent 1957
Average Hourly Wage and Salaries in Constant Purchasing Power	100	132.8
Average Hourly Compensation in Constant Purchasing Power (including pension, hospitalization and other fringes)	100	135.8
Real Product Per Man-Hour, All Persons Total Private Economy	100	137.0

Source: U.S. Congress Joint Economic Committee, September, 1958

This should help dispose of the argument that unions, spearheading the drive for wage and salary earners, have put labor in the driver's seat and made gains at the expense of other groups in the economy. However, a word of caution is in order regarding the comparisons between money wages and productivity.

Productivity figures measure the actual change in the physical output of goods and services. Money wages, on the other hand, do not reflect changes in a worker's ability to purchase such goods and services. Only when money wages are adjusted, as has been done above to allow for the fact that rising prices have reduced the value of the dollar, do we have a real measure of the worker's ability to purchase goods and services. It is real earnings and not money earnings which must be compared with real increases in output per man-hour to determine whether workers have received a fair share of the increasing fruits of industry.

The data on wages and productivity during the past few years clearly can completely discredit the idea that unions and workers have profited at the expense of other groups during the inflation.[6]

The Rise in Manufacturing Prices

Unions have been relatively more successful in organizing the production and maintenance worker in big manufacturing industries. Therefore, an examination of wages, costs and prices in the manufacturing part of our economy alone can provide an even better test of whether or not union wage policies have been the cause of inflation. If a union-led inflationary wage squeeze were taking place, we should see it here clearly.

Mr. Murray Wernick, Senior Economist of the Federal Reserve Board, has recently completed a study which sheds interesting light on this question. Taking the average for the years 1947-49 as a base, Wernick studied the unit wage costs in manufacturing between 1947 and 1957; that is the amount of money spent on wages for each unit of output.

If we compare Wernick's figures on unit wage costs with the wholesale prices of all commodities other than farm products and food, what we will find is shown in Table II.

As we can see, unit wage costs went up 15.7 percent in this period. What happened to the industrial price level during the same year? It jumped 25.6 percent. It should be remembered that the 15.7 percent increase in money

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[6] *Ibid.*, pp. 6-8.

wages.[7]

TABLE 2

INDEXES OF UNIT WAGE COSTS AND WHOLESALE
INDUSTRIAL PRICES 1947-1957
(1947-49 = 100)

Year	Unit Wage Cost	Wholesale Industrial Price Index
1947	96.8	95.3
1950	99.3	105.0
1953	114.1	114.0
1954	110.6	114.5
1955	11.6	117.0
1956	114.7	122.2
1957	115.7	125.6

Source: U.S. Department of Commerce, 1958.

The steel industry and its powerful corporate leader, U. S. Steel, furnished a good example of the inflationary pricing policies followed by big business in general. This basic industry is dominated by four corporations which account for well over half of all the steel capacity in the United States (58.3 percent during the first six months of 1957). As a matter of fact, if we use a more meaningful measure of market power -- the degree of control over specific steel products such as steel rails or axels -- we find that the dominance exercised by a handful of firms is even greater. For example, during the first half of 1957, four companies controlled the entire shipment of eleven products (over one-fourth of the number of individual steel products) and more than 75 percent of ten other products.

A recent inquiry by the U.S. Senate shows what happened to steel prices

[7] *Ibid.*, pp. 12-13.

in 1957. In July of that year, the United Steel Workers of America received a wage increase carefully estimated by the union on the basis of data submitted by the steel companies at about 16.4 cents per hour. (U.S. Steel inflated the figure to 19.4 cents per hour in its testimony before the Senate Committee.)

At the time the wage adjustment was made, the steel workers union pointed out that productivity in the steel industry was rising so rapidly the companies could easily absorb the wage increase, keeping prices stable and still making record profits. The union estimated the rate of productivity increase in the first four months of 1957 was about five percent on an annual basis.

Between 1947 and the spring of 1957, for example, while unit labor costs had increased only a total of 34.7 percent, the steel industry had raised prices 96.3 percent, or nearly three times more than the increase in its labor costs.[8]

Steel is not the only example of a major industry dominated by a handful of powerful corporations which are free from the checks and balances of competition.

The automobile industry also establishes prices without any regard for the public interest. Here, three companies control over 97 percent of the industry's output, and one of them, General Motors, is currently taking over 50 percent of the auto market.[9]

On September 29, 1959, Ford announced its prices for its 1957 models, with increases ranging up to $104. The Company explained, "our prices are

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[8] Ibid., pp. 18-19.

[9] Ibid., p. 24.

increased no more than our actual cost for materials and services has gone up...". The clear implication was that the price increases covered the cost increases.[10]

Three weeks later General Motors announced its 1957 Chevrolet prices. On four comparable models, the Chevrolet Model was five dollars below Ford, on one it was the same, and on nine models it was $23 to $53 higher.

Within two days, Ford came out with a new announcement. As might normally be expected, Ford lowered its prices downward in those cases where comparable Chevrolet Modles were below Fords and raised the prices on the remaining models to meet the prices of Chevrolet. It took advantage of this opportunity to increase its profit margins, rather than compete with lower prices and increase its share of the market.

This is clearly a case where competition is no longer as effective as before where one company sets prices and other merely follow. This road, too, leads to inflation.

Writing in 1924, Donaldson Brown, a vice-president of General Motors gave us at least a partial picture of the General Motors' price-making process. (Article published in Management and Administration, February-April, 1924). He suggested that prices were set to gain a certain pre-determined long-term rate of profit on an average or standard volume of production.

Since this is the case, it becomes important to know what profit rates General Motors sets as its normal goal and how it calculates its standard volume or average level of operations. According to Mr. Brown, General Motors assumes that, over the long haul, the maximum rate of profit it can

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[10] _Ibid._, pp. 24-25.

consistently enjoy is twenty percent of total invested capital, after taxes. (Another General Motors vice-president did not want to be pinned down in 1955, but in testifying before a Senate Committee, he spoke of a target rate of return of "between 15 and 20 percent" -- also after taxes.)[11]

At what level of operations does General Motors expect to earn that 20 percent, after tax return? At 100 percent of capacity? At 90 percent of capacity?

A recent article by Daniel Cordtz in Wall Street Journal notes:

> What's the industry's calculated standard volume today? Estimates range all the way from 33 percent of capacity to 80 percent. 'My guess', says one executive, 'is that the industry as a whole has a total capacity of 10 million cars and an aggregate standard volume of perhaps 55 percent of that, or 5.5 million cars'".[12]

Big Business and Price Administration

The prevalence of administered prices in vast areas of our economy is not open to serious question. What is debated is whether the prices are sensitive to market changes; whether the sellers abuse this power to over-price the goods and services they market; and tend to divert purchasing power from other areas to themselves to such an extent as to constitute a drag on the entire economy, to stimulate inflation and, subsequently, a recession.

A considerable body of expert opinion now associates the appearance of "creeping inflation" with this control of our price structure by large, dominant corporations who act as price leaders and set prices according to predetermined cost-plus formulas, reinforce their own market position

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[11] Ibid., pp. 25-26.

[12] Wall Street Journal, December 10, 1957.

through advertising and other forms of non price competition, and whose hugh profits have graded unions on to seek high wage increases. These men see, in the modification of price policies and behavior of these large companies, the possibility of substantially restraining creeping price increases and in stabilizing our price level and economy.

There is much support for the above position both on the basis of experience and theoretical grounds. Most of the price increases in recent years have taken place in the fields dominated by large corporations which tend to administer their own price system. Moreover, there has been a market tendency in some areas for prices to move only in one direction, namely, upward. The recent price reduction in the aluminum industry which was subsequently canceled, interestingly enough was attributable to the Russians under-selling the Aluminum Corporation in British markets rather than any competitive factors in this country.

Gardner Means, in his testimoney before the Senate Antitrust and Monopoly Subcommittee, reported on his analysis of wholesale price changes from June, 1955 to June, 1957. For 80 commodities, "wholesale prices changed less than 8 times in an 8-year period and for 92 commodities...prices changed more than 77 times in the same period." He found that "market prices declined on the average 1.4 percent while the administered prices rose on the average 10.2 percent." He concluded that "in so far as these data represent a fair example of wholesale price behavior for market prices and for the least changing administrative prices, they indicated that the major movement in the last 2 years has come in the most administered prices and not in market

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[13] The Relationship of Prices to Economic Stability and Growth, op. cit., pp. 12-14.

prices as a group." After a study of food and agricultural prices which he found had declined, and physical food consumption, which remained stationary, he concluded that "the current inflation is not the result of a general rise in demand but is a product either of a specialized increase in demand which has not spread out, or lifted demand in general, or is a product of upward price revisions within the area of pricing discretion."[13]

Additional evidence of the over-riding influence of the administered price sector upon our economy is supplied by the relative price behavior of the durable and nondurable goods industries over the period from 1947 through 1957. The wholesale price of durable good manufactured (which were identified as consisting of the prices for consumer durables and producer finished goods in the wholesale price series), in which area a substantial proportion of the producers are subjected to administrative price control, rose by 53 percent as compared to 10 percent for the non-durable goods industries. During this same period the comparative rise in unit labor costs for the durable goods industries was 15 percent and the non-durable goods industries, 11 percent. The wholesale prices for durable goods increased more than three times the rise in unit labor costs, whereas the increase in wholesale prices for the non-durable goods actually was less than the rise in unit labor costs.[14]

The power of those corporations administering prices in the key industries is best exemplified through the analysis of individual industries. The report by the Kefauver Subcommittee on Antitrust and Monopoly highlights this issue in the steel industry as revealed by the study of the price increase of July,

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[13]The Relationship of Prices to Economic Stability and Growth, op. cit., pp. 12-14.

[14]Ibid., p. 4.

1957. The industry has been highly concentrated, with the United States Steel Corporation maintaining a dominant position and acting as price leader. The "practice of price leadership...appears to operate just as effectively when prices are increased as when they are reduced." The report finds that there have been relative few entrants into the industry in recent years and several constructed their facilities with the aid of the Federal Government.

As elaborate price system has been in use in the steel industry which was derived from an earlier basing-point arrangement which has "produced complete identity of delivered prices at any given point of destination".[15] As for prices, they have moved on a number of occasions in the opposite direction to that which would have been indicated by the changes in demand. Thus the steel price index continued its virtually unbroken rise even when demand and production declined (as they did in 1947, 1954, and 1957). It also continued its climb even when unit labor costs declined (as they did in 1950 and 1955). The committee also concluded that the price increase substantially exceeded the cost increase in 1957 and apparently also in 1956. It is also reasonably clear that at the time the 1957 price increase was made there was nothing in the information available to suggest a forth-coming increase in demand which would support higher prices.[16]

Most significant, the committee found that the 1956 and probably the 1957 price increase widened the margin between unit costs and prices. The "break-even" point for "both the steel industry as a whole and the United States Steel Corporation individually is shown to be slightly below an

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[15] Ibid., p. 15.

[16] Ibid.

operating rate of 40 percent of sales."[17] One of its expert witnesses, a management consultant formerly associated with the industry, estimated that in the third quarter of 1957 the break-even point for U.S. Steel Corporation had dropped to 32 percent of capacity. This estimate of the break-even point within the industry, coincides with those currently used in the financial community in estimating profits. The latter placed it at 37 percent of capacity for the U.S. Steel Corporation and at a comparable level for other leading producers.[18]

The price increase was not "at a level above what the market can support." The industry made no effort to help customers develop markets through lower prices. This possibility it has discounted on the assumption common among many oligopolists that the demand for steel was essentially inelastic. While many users of steel are definitely responsive to price and are handicapped by these increases, the industry minimizes its significance in affecting its total operation.[19]

Administered prices in most instances are not responsive to demand and are set on artificial and questionable assumptions. Their profit target tends to be unduly high and designed to finance all or a substantial portion of the company's expansion from internal sources. Sellers utilize their economic power to maintain high prices. Concession like lower prices are seldom made when operations rise above standard levels and few efforts are made to encourage demand through price cuts where production is low. The

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[18] Ibid.

[19] Ibid., pp. 15-16.

companies have stood by these higher prices irrespective of national policy and objectives. They feel no responsibility for making their pricing policies rise with the Nation's objective of attaining "maximum employment and production." Their practices, moreover, stimulate inflation.[20]

Major Service Areas

Many commentators have already observed that price increases for the service components of the Consumer Price Index have pressed hard upon our cost of living. Much of the overall inflation has stemmed from this source. While the Consumer Price Index increased by 8.1 per cent from June 1955 to June, 1958, the rise among the services was 9.8 per cent. In each of the last 3 years, the rise in the service component was more than in the commodity components. From June, 1955 to June 1956, the rise in the commodities as compared with services was 1.3 per cent to 2.1 per cent; for the year from June, 1956 to June, 1957, 3.1 per cent to 3.9 per cent; and for the last year, from June, 1957 to June, 1958, 2.6 per cent to 3.5 per cent.[21]

The highest increase in prices for the 3 year period was in medical care, 13.8 per cent. The others in decending order were as follows: personal care, 12.1 per cent; transportation, 10.4 per cent; reading and recreation, 9.9 per cent; and housing, 6.7 per cent. All of the items but housing exceeded the overall rise in the Consumer Price Index.[22]

The increases in the cost of services may originate from either one of two sources. First, they may represent higher prices from the article being

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[20]*Ibid.*, pp. 16-17.

[21]*Ibid.*, pp. 26-27.

[22]*Ibid.*, p. 27.

used such as drugs in the case of medical care, automobiles in transportation, toilet goods for personal care, radios for recreation, or fuel for homes. Second, the services themselves may cost more as in the case of hospital care, higher doctor or dentist fees, transportation fares, barber and beautician prices, home maintenance costs, or postage rates.[23]

Unlike in other areas in the cost of living most of the impact of the higher prices and charges is transmitted directly and in full to the consumer, compensating improvements in efficiency have been modest. The prices for materials passed on to the consumer reflect in part the power of the oligopolist to raise and maintain his charges.

Another complication in appraising the cost of services related to the level of labor rates. There are basically three types of groups in so far as our analysis is concerned. There are, first the hundreds of thousands of workers in these fields whose pay has been and continue to be substandard. These include workers in laundries, dry-cleaning establishements, hospitals, buildings, and telephone and telegraph industries. Upward adjustments in wages for these persons are imperative if we are to eliminate repressive wage rates in this country. Second, there are those workers whose rates are more nearly in line with most other groups and whose wages are set either unilaterally, which is true for the greater number, or theough collective bargaining. Finally, there are the independent professionals such as doctors, dentists, lawyers and others whose professional fees have risen markedly. Many questions have been asked concerning this final or professional group. They set their own fees. Have they raised their fees without re-evaluating the changes in their professional life cycle so that they owe it to the country

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[23] *Ibid.*

to work out a more rational scale of payment; and, of course, as in other instances, one of the questions arising respecting prices is whether the profit margins have been raised as well. There is evidence that such rise has occurred in many service fields.[24]

Government Spending

Government spending declined sharply from the World War II peak after the war but then began a substantial rise. From 1947 -- their low point -- to 1957, government purchases of goods and services rose 71 per cent. State and local purchases increased by almost as large a percentage as Federal purchases.

The rise in government spending was itself partly the result of rising prices. But, even after taking account of this, real government purchases rose by 103 per cent -- much more, proportionately, than the rise in private purchases. The main cause of this large increase in the demand for goods and services by government were the requirements of national security, the backlogs of need left at the end of the war, and the growth of population -- the last two being especially important at the state and local level. But, of course, there were many other forces at work.

The fact that the economy was not on a "peacetime" basis, in the sense that the word is ordinarily used, contributed to inflationary pressures. National Security expenditures reached 14 per cent of the gross national product in 1952 and 1953, and never fell below 10 per cent thereafter. The high level of defense expenditures, even when they were not rising, had an inflationary influence probably disproportionate to the amounts spent. Competition for labor and materials by defense contractors and the prices and wage rates they can pay

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[24] Ibid., pp. 27-28.

are not limited in many cases by the necessity to meet market competitoon. The special demands of defense production and hoarding of personnel in defense plants have resulted in substantial shortage of managerial, professional, technical, and skilled personnel. The higher wage rates caused by these factors spread into other industries, first in the same area and then elsewhere.

For the postwar period as a whole, Federal government expenditures were balanced by taxes. This did not, however, take the inflationary sting out of the rise of expenditures. Expenditures increased more, from 1947 to 1957, than tax collections increased. Thus, the surplus of government income over outgo was smaller, both absolutely and in relation to national income, at the end of the period than at the beginning.

Even if the rise of expenditures had been exactly matched by the rise of tax collections, it would probably have had the effect of increasing total demand (private plus government spending). This is so because, in part, the higher taxes necessary for such a balance would probably have reduced private savings, not private spending, so private spending would not have been out as much as government spending rose.[25]

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[25] "Defense Against Inflation," op. cit., pp. 23-24.

CHAPTER IV

SUMMARY AND CONCLUSION

In general, prices have moved upward in three distinct waves since the end of World War II. The first wave, reflecting the pent-up demand of consumers and businessmen following four years of wartime shortages and controls, began at the end of 1945 and ended in the summer of 1948. The second wave, which was dominated by developments in Korea, was concentrated mainly in the latter half of 1950 and the early months of 1951. The third wave extended from mid-1955 through most of 1957. Prices declined on the average between the first and second wave -- a period which coincided with the 1948-49 recession; but they were stable or rose moderately between the second and third waves -- a period which covered years of high employment as well as the 1953-54 recession.

The dominating influences on prices in the past ten years have been continued strong demands in most lines of business and rising costs. However, there have been significant changes in relative prices, reflecting the differential impact of changing demand-supply and cost-profit relationships in different sectors of the economy. The most striking differences, particularly in the latter half of the past decade, have been (1) the independent movement of prices of services on the one hand and of prices of commodities on the other; (2) the sharp decline in farm prices relative to the prices of non-farm commodities; (3) the under swings in raw materials prices rather than in prices of manufactured goods; (4) the large and presistent increases in the prices of producers' equipment and of construction, even during periods when consumers goods prices were falling or stable; and (5) the narrowing of margins between the wholesale and retail prices of consumer durable goods.

Unit labor costs in private, non-agricultural industries followed roughly the same pattern as the general price level. They rose sharply in three years after the end of World War II, in 1951 and 1952 and again in 1956 and 1957; the decline between the first and second waves; and rose slightly between the second and third. Price increases preceded unit labor cost increase, but, for the entire period 1947-57, the cumulative increase in unit labor costs was somewhat larger than the cumulative increase in prices.[1]

The traditional theories certainly still occupy a dominant place in most current thinking. That is to say, the conception that the price level is basically a reflection either of the value of the standard money, or of changes in the quantity of circulation media as compared with the volume of goods, premeates most of the literature of recent times. The value of gold theory is implicit in the proposals for the restoration of the gold standard; and there are survivals of it in the textbook literature. The quantity theory prevades the discussion of deficit financing and "monetization" of the public debt; it is inherent in statements about velocity of circulation; and it is the heart of discussions of credit policy as a means of controlling the price level.

Some attempt has been made to reconcile divergent points of view with respect to monetary theory. Most textbook writers find harmoney rather than disharmony in the several theories, and hold that there is an underlying consistency running through all of them. Such differences as appear

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[1]"Defense Against Inflation," op. cit., p. 71.

are held to arise out of the varying time periods on which they are focused. The quantity theory of money is held to be a sound explanation of long-term price trends, while the income approach furnishes a more adequate explanation of short-term fluctuations.

The income approach occupies a larger place in current thinking. This theory originated, it may be recalled, in the idea that the amount of money available for spending is governed by current income in the form of wages, interest, etc., rather than by the over-all supply of gold and credit currency.[2]

As a result of this explanatory examination of price behavior over the period 1947-57, the following can be advanced: The record of the American economy regarding prices during the postwar period is a relatively good one. By far the largest proportion of price increases in the circumstances arise either from the aftermath of World War II or Korean hostilities. Even during the past two years when some economists assigned the blame to "wate inflation," most of the price increases recorded by the Consumer Price Index can be attributed to special circumstances, such as crop conditions, rather than to union-won wage increases. Although real wages seem to have risen more than productivity during the two year period 1955-57, when viewed in the context of the entire postwar period, it is clear that employees have not gained a greater share of the benefits of productivity than other groups in society. Increased spending by the Federal and local governments was effective in increasing the money supply. And the pricing policies of business corporations, those who administer prices, as well as

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[2]Harold G. Moulton, op. cit., pp. 35-36.

those who follow administered pricing policy, played a very important part in the inflating of prices in the interim, 1954-57.

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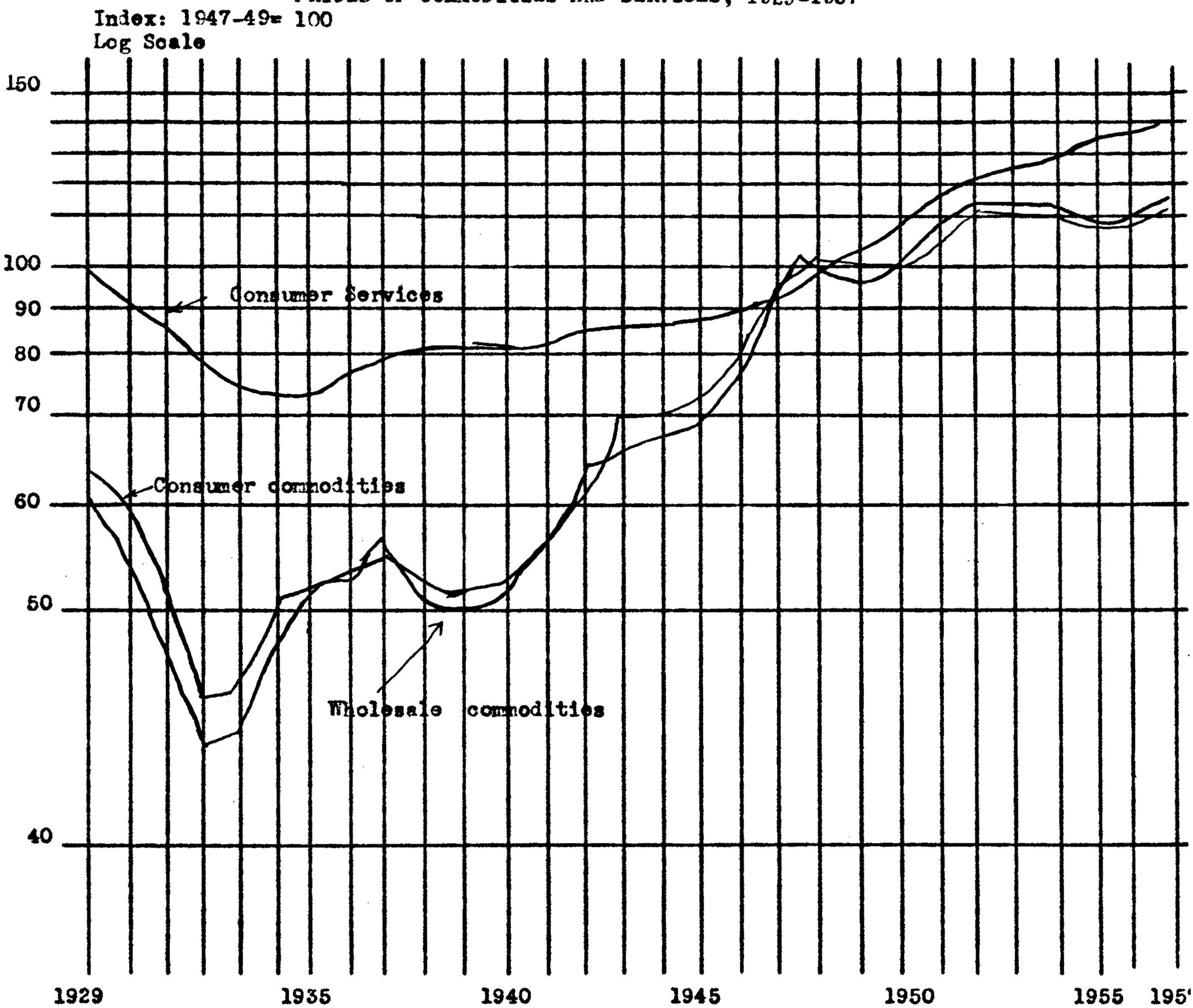
APPENDICES

The appendices illustrate through a series of charts the major price and labor developments in the past decade.

CHART I

PRICES OF COMMODITIES AND SERVICES, 1929-1957

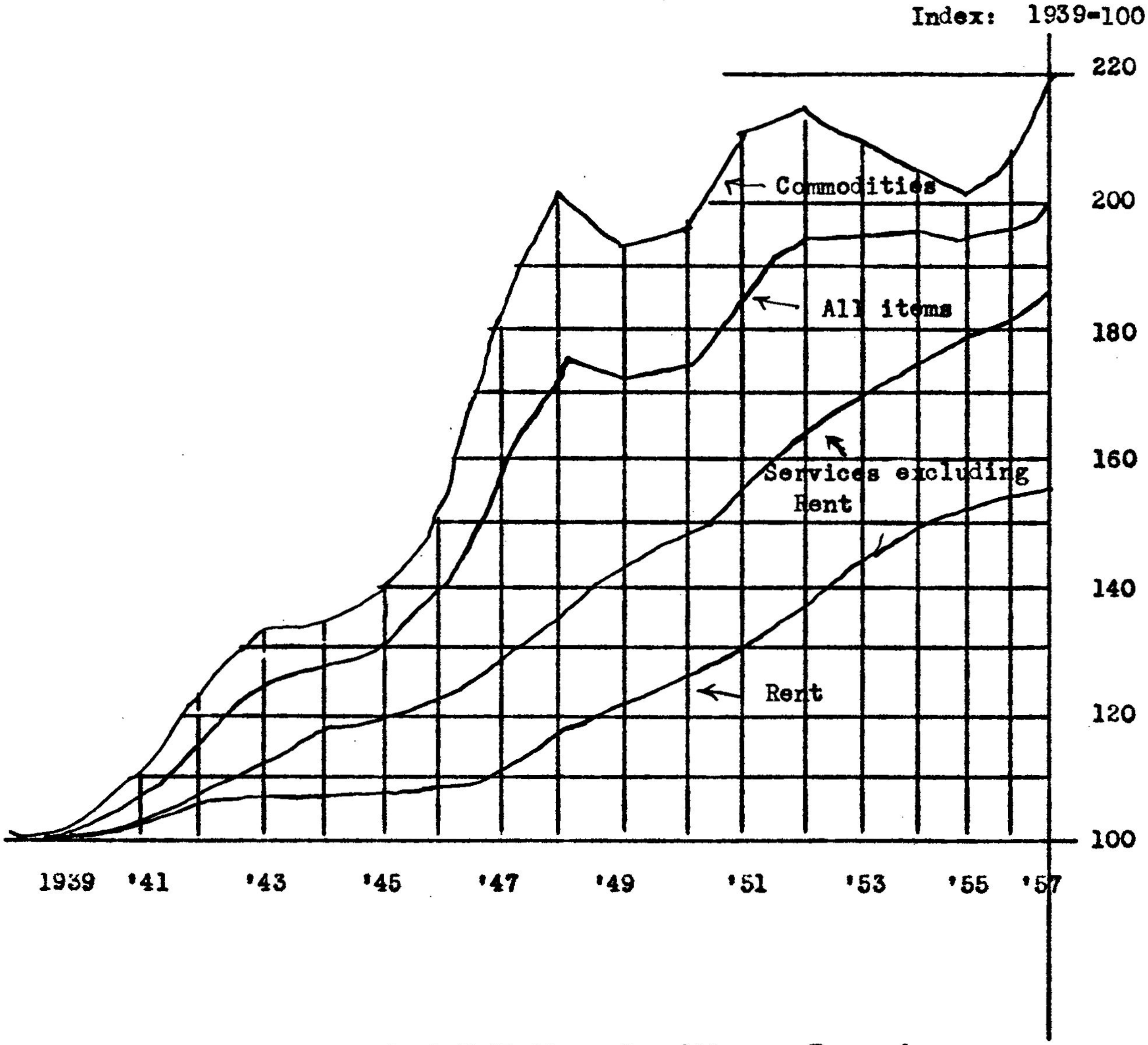


Source: "Defense Against Inflation," Committee for Economic Development, 1958

Commodity prices at both the wholesale and retail levels clearly reflect the three waves of 1946-48, 1950-51, and 1955-57 and the intervening interruptions, but postwar prices of services (including shelter) show a continuous upward movement in recession as well as in years of high employment. Service and shelter prices lagged substantially behind commodity prices between 1939 and 1951 and they are still adjusting to postwar demand conditions.

CHART II

CONSUMER PRICES ON A PREWAR BASE, 1939-1957

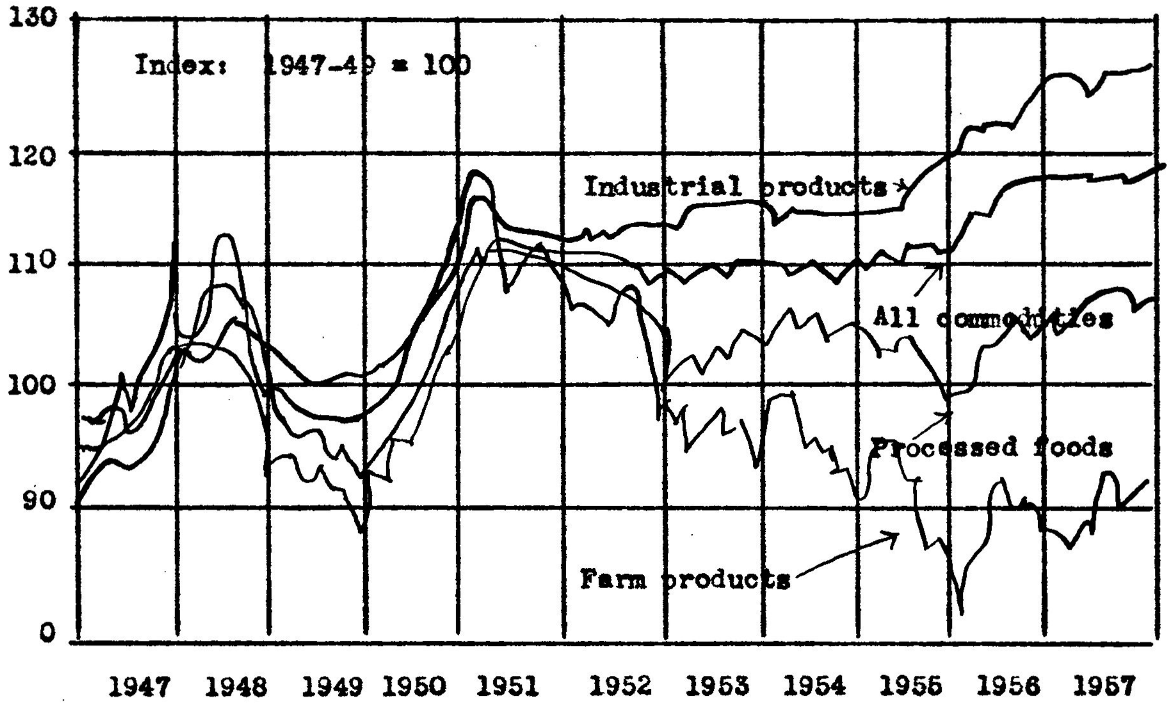


Source: Defense Against Inflation, Committee on Economic Development, 1958

The average of all consumer prices for the year 1957 was about doubled the average for 1939. For the period as a whole, prices of consumer commodities rose much more than the prices of consumer services and rents. Since 1951, there has been relatively little change in the level of consumer commodity prices as a group, while rents and the prices of other services have continued upward. However, these changes have not yet restored the prewar relationships.

CHART III

WHOLESALE PRICES OF FARM PRODUCTS, PROCESSED FOODS AND INDUSTRIAL COMMODITIES
1947-1957



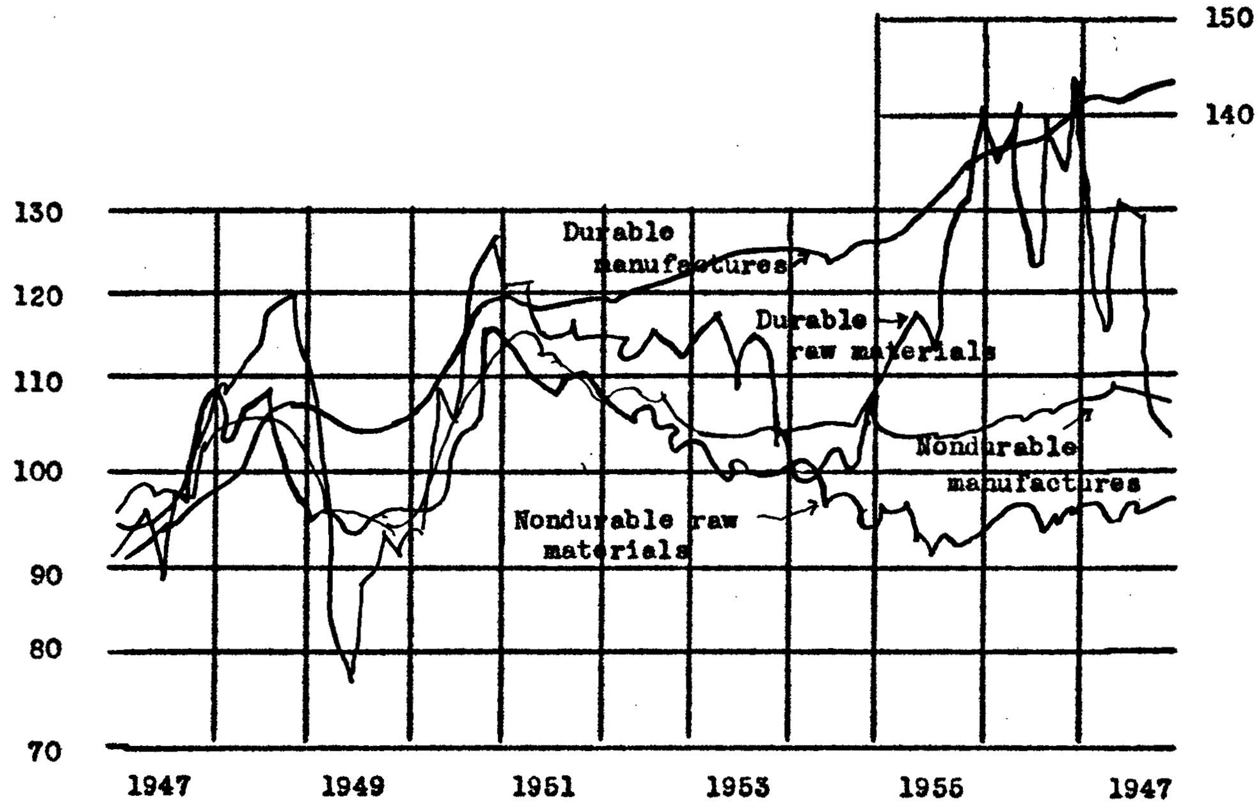
Source: Defense Against Inflation, Committee on Economic Development, 1958

Although the index of wholesale prices changes little on balance between the two peaks of 1951 and 1957, there were substantial and divergent movements in its major components. Industrial prices moved within a narrow range until mid-1955 and then rose sharply. Farm prices dropped almost 30 per cent between early 1951 and the end of 1955 and recovered less than a third of this drop in the next two years. Prices of processed foods generally followed the trend of farm prices, but their fluctuations were much milder. In December 1957, industrial prices were 8 per cent higher than in March 1951, while farm prices were 21 per cent lower and the prices of processed foods were 4 per cent lower.

CHART IV

WHOLESALE PRICES OF DURABLE AND NONDURABLE
MANUFACTURES AND RAW MATERIALS
1947-1957

Index: 1947-49 = 100

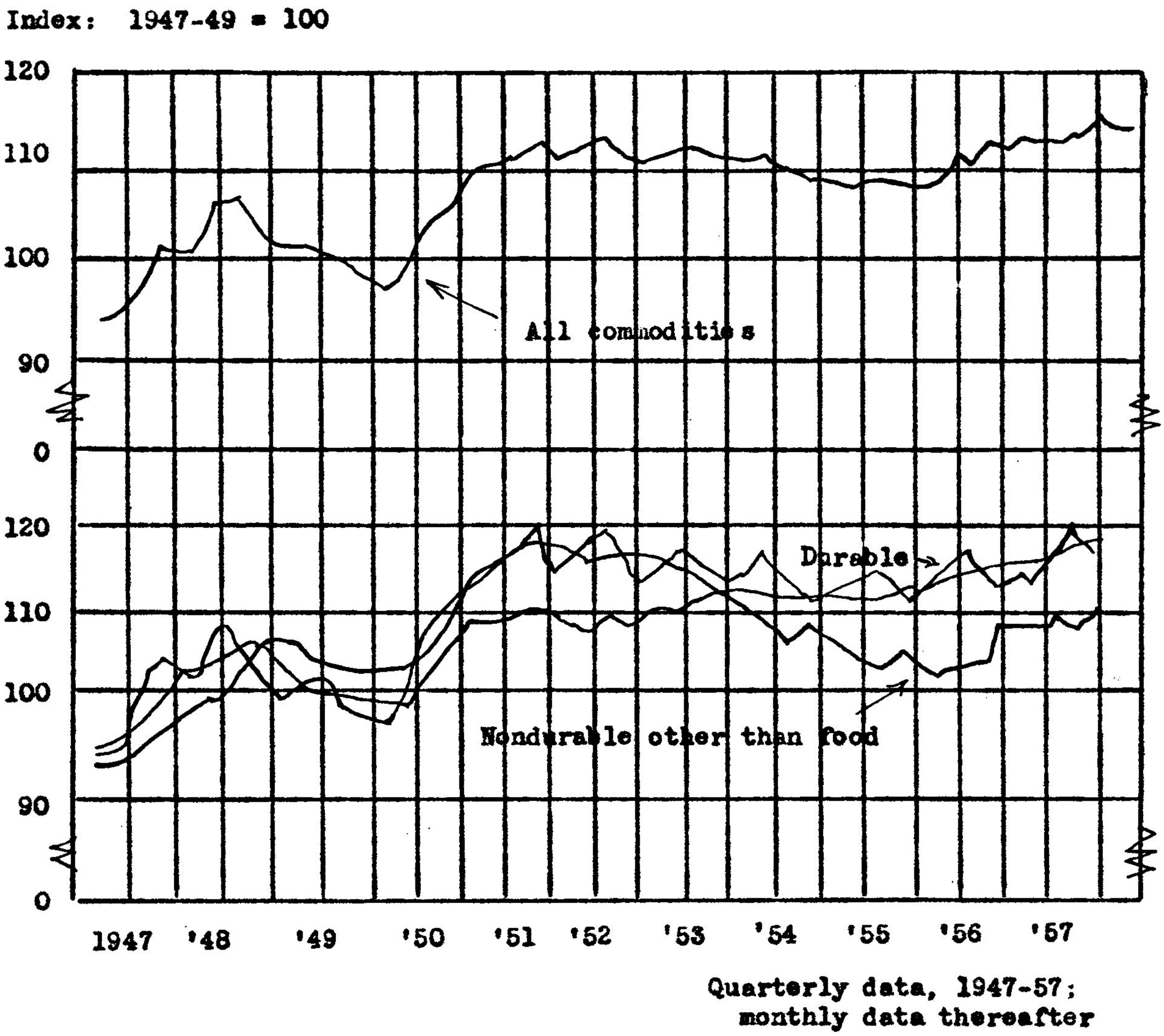


Source: <u>Defense Against Inflation</u>, Committee for Economic <u>Development, 1958</u>

Despite a rise in 1956 and 1957, wholesale prices of nondurable manufactures are still below their 1951 peaks. Wholesale prices of durable manufactures, on the other hand, are substantially higher. Nondurable raw materials prices reflect the long downward trend in farm prices. The prices of durable raw materials have fluctuated violently in recent years because their supply does not adjust rapidly to changes in demand. Durable raw materials prices reached record levels at the end of 1956 and then dropped sharply as demand for these products declined.

CHART V

CONSUMER COMMODITY PRICES
1947-1957



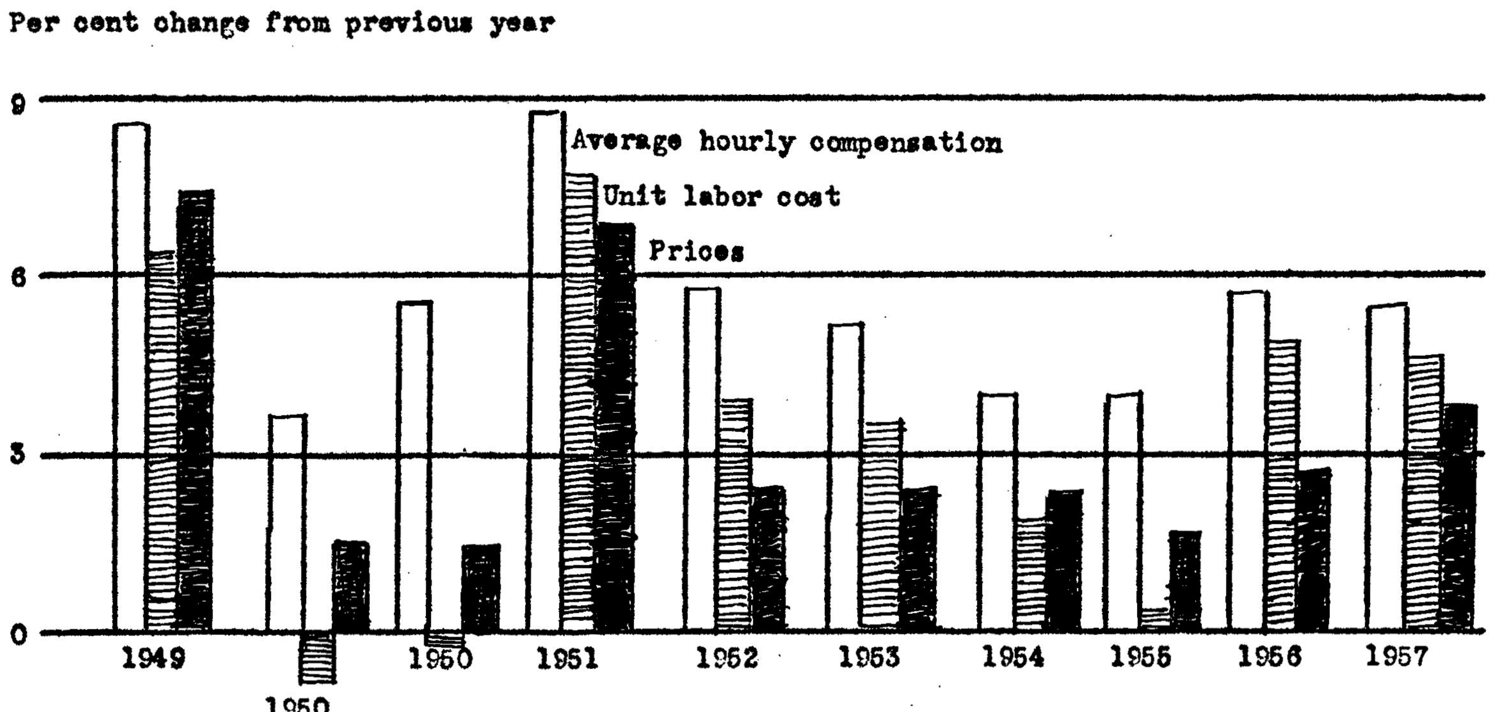
Source: Defense Against Inflation, Committee for Economic Development, 1958.

The distinguishing feature of consumer commodity prices during the past decade was the long slow decline that followed the forward buying and hoarding of consumers during the early months of the Korean War. The average of all consumer commodity prices went down 3 per cent between December 1952 and December 1955. Food prices declined 9 per cent, while consumer durable goods prices declined 9 per cent as a result of the reduction of retail margins. Prices of nondurable goods other than food rose 4 per cent. The substantial upturn that began in the spring of 1956 affected all consumer commodity prices, reflecting the heavy demands on materials and labor by the investment sector of the economy, smaller-than-average gains in productivity, and rising labor and raw materials costs.

CHART VI

ANNUAL CHANGES IN AVERAGE HOURLY COMPENSATION,
UNIT LABOR COSTS, AND PRICES, 1948-1957

All Private Nonagricultural Industries

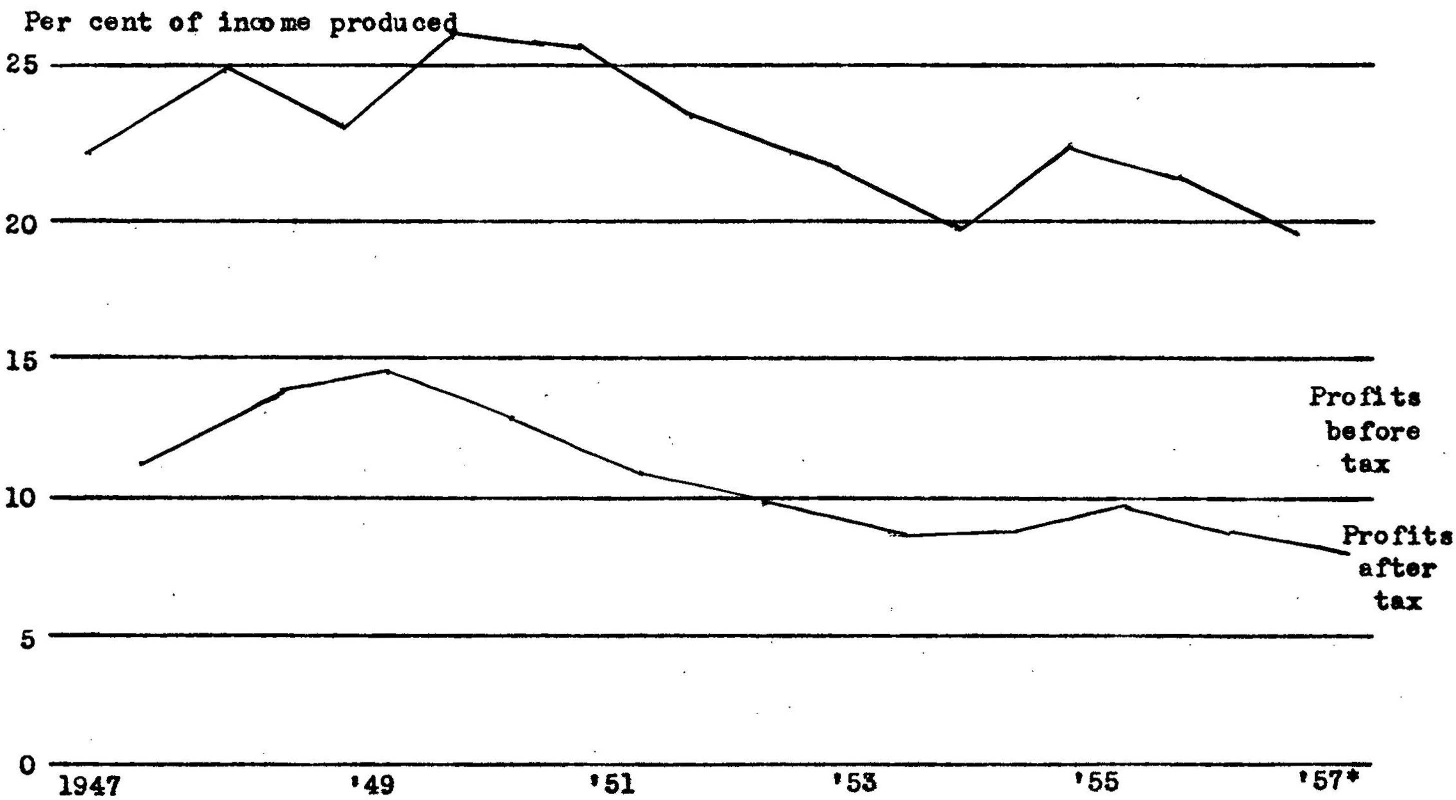


Source: Defense Against Inflation, Committee for Economic Development, 1958.

Average hourly compensation rose every year between 1947 and 1956, with increases ranging from a low of 3.1 per cent in 1949 to a high of 8.7 per cent in 1951. Unit labor cost increases were smaller because the increase in compensation was offset by increases in productivity. Nevertheless, unit labor costs rose sharply in 1948, 1951-53, and 1956-57. Prices led unit labor costs in 1948, 1949 and 1950, and again in 1954 and 1955, but unit labor costs soon caught up. For the whole period 1947-57, the increase in unit costs was slightly higher than the increase in prices.

CHART VII

PROFITS AS A PER CENT OF INCOME PRODUCED
BY CORPORATIONS, 1947-1957



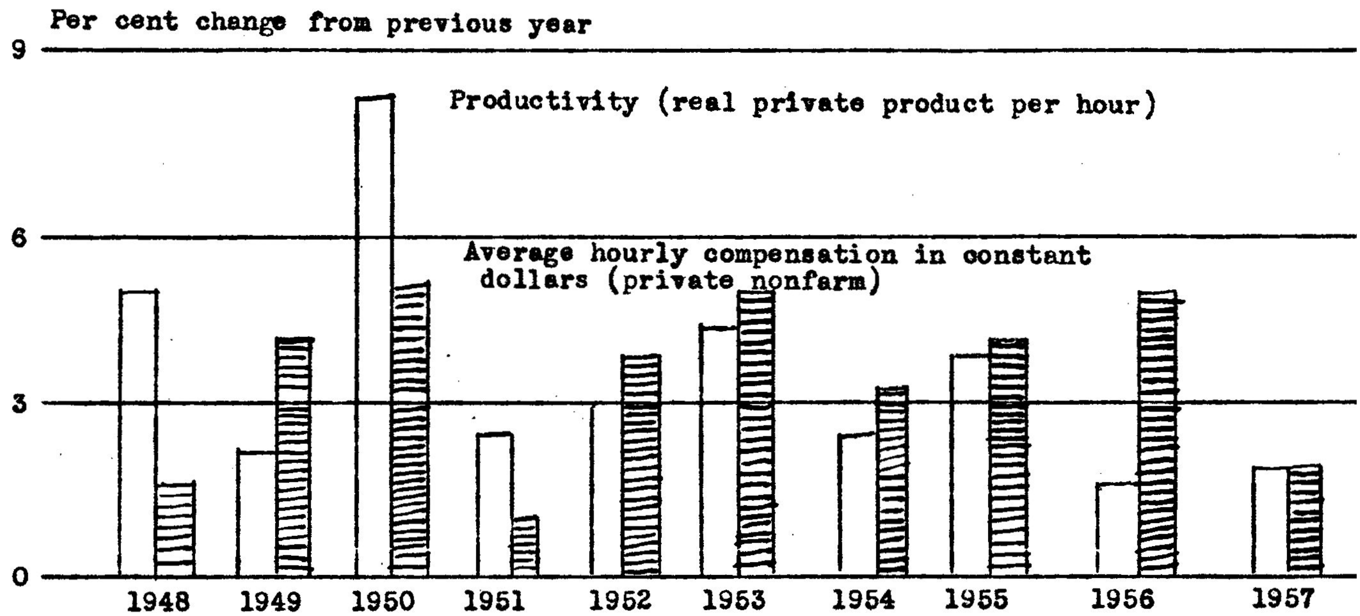
Note: Profits exclude inventory gains and losses *First nine months

Source: Defense Against Inflation, Committee for Economic Development, 1958.

Profits before taxes started out at 22 per cent of income produced by corporations in 1947 and ended at less than 20 per cent in 1957. The lag of unit labor costs behind prices in the period 1948-50 shows up as an increase in the profit share from 22 per cent to 26 per cent. As labor costs caught up, the profit share declined and, by 1954, it was down to 20 per cent. In 1955, price increases again exceeded labor cost increases and the profit share went up to 22 per cent. Increased labor costs, which were due partly to wage increases and partly to the reduced rate of increase in productivity, resulted in a profit squeeze in 1956 and 1957, and the profit share declined again -- bringing the figure for 1957 below the level at which it started ten years earlier. Profits after taxes show approximately the same trends.

CHART VIII

ANNUAL CHANGES IN PRODUCTIVITY AND REAL EMPLOYEE COMPENSATION
1948-1957



Note: The measure of productivity used in this chart is affected by shifts between the farm and nonfarm sectors as well as shifts within these sectors, whereas nonfarm average hourly compensation is affected by shifts within the sector only.

Source: Defense Against Inflation, Committee for Economic Development, 1958.

In 1948, 1950 and 1951, productivity ran ahead of average hourly compensation in constant dollars, but between 1952 and 1956 the increases in real compensation exceeded productivity gains. Particularly noteworthy is the decline in the rate of increase in productivity in 1956 and 1957. As indicated in the two previous charts, this lag in productivity was reflected partly in increased prices and partly in reduced profit margins.